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No. 87-1613

In The
Supreme Court of the United States
October Term, 1987

PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE,

Appellant,

v.

NEW HAMPSHIRE,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF NEW HAMPSHIRE

MOTION OF APPELLEE STATE OF NEW HAMPSHIRE TO DISMISS [OR AFFIRM]

STEPHEN E. MERRILL
Attorney General
LARRY M. SMUKLER*
Senior Assistant Attorney General
Civil Bureau
25 Capitol Street
Concord, New Hampshire 03301-6397
(603) 271-3658
Attorneys for Appellee

**Counsel of Record*

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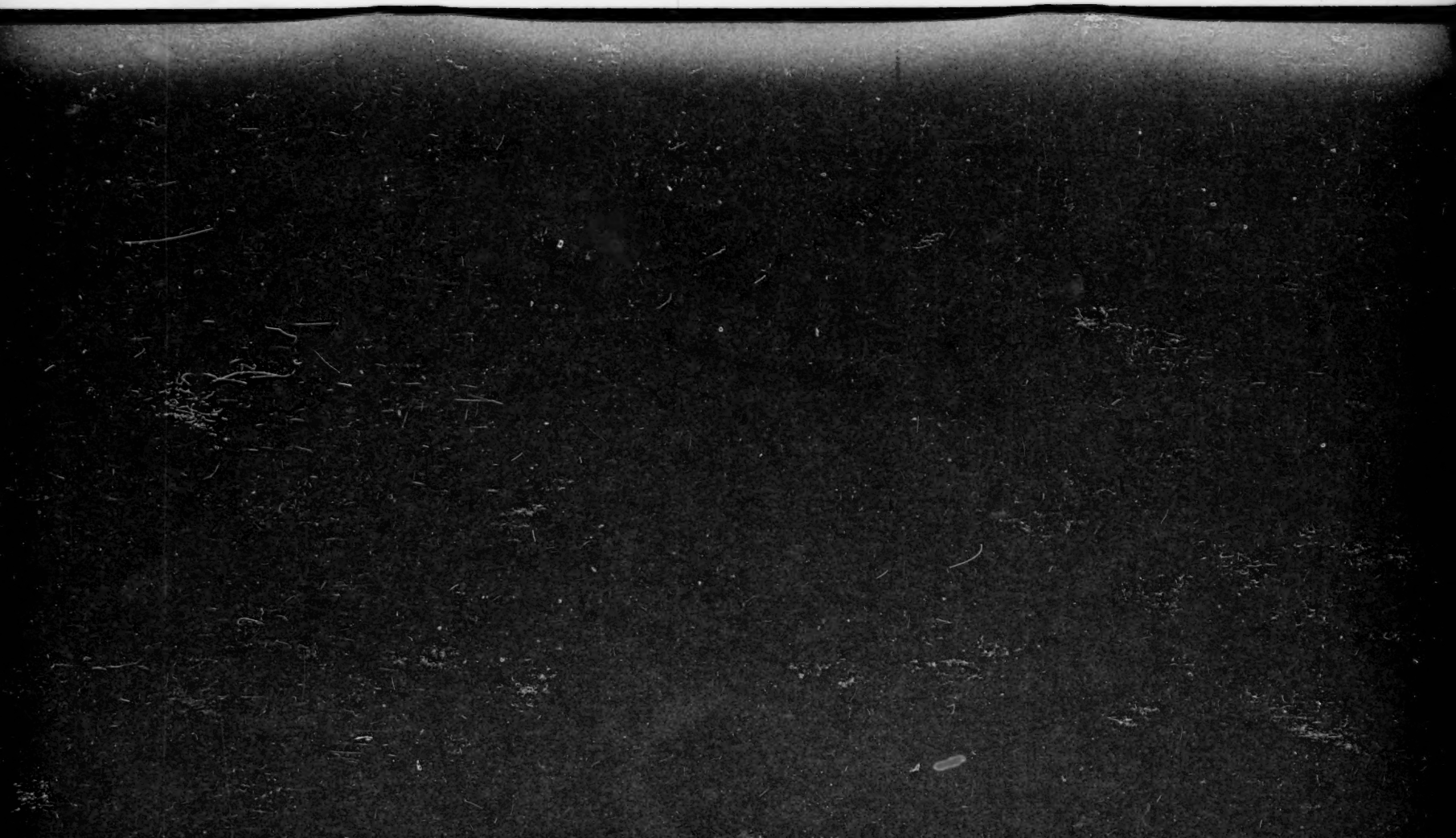
COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831



QUESTION PRESENTED

Whether the Supreme Court of New Hampshire correctly held that New Hampshire Rev. Stat. Ann. § 378:30-a (1984) may be applied to a financially distressed utility in a manner consistent with U.S. CONST. amends. V and XIV given that (1) the statute reflected a rational legislative balancing of ratepayer and investor interests, and (2) the New Hampshire Public Utilities Commission consistently applied the statute to provide the utility's investors with just compensation?

PARTIES BELOW

The petitioner below was Public Service Company of New Hampshire (PSNH or Company). The State of New Hampshire (State) was the respondent below. The Consumer Advocate, Michael W. Holmes, and the Campaign for Ratepayers' Rights (CRR) were intervenors below.

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ON APPEAL FROM THE SUPREME COURT OF NEW HAMPSHIRE

MOTION OF APPELLEE STATE OF NEW HAMPSHIRE TO DISMISS [OR AFFIRM]

The appellee State of New Hampshire moves the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of New Hampshire on the ground that it is manifest that the questions on which the decision of the cause depends are so unsubstantial as not to need further argument.

STATE STATUTE INVOLVED

N.H. Rev. Stat. Ann. § 378:30-a (1984):

Public Utility Rate Base; Exclusions. Public utility rates or charges shall not in any manner be based on the cost of construction work in progress. At no time shall any rates or charges be based upon any costs associated with construction work if said construction work is not completed. All costs of construction work in progress, including, but not limited to, any costs associated with constructing, owning, maintaining or financing construction work in progress, shall not be included in a utility's rate base nor be allowed as an expense for rate making purposes until, and not before, said construction project is actually providing service to consumers.

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COUNTERSTATEMENT OF THE CASE

In the early 1970's, PSNH management staked the Company's future on management's ability to construct an electric generating facility (Seabrook) in a timely and cost-effective manner.[1] On January 28, 1988, PSNH management, having failed in its attempt, filed for protection from the Company's creditors under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101 *et seq.*

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[1]PSNH management filed an application for a certificate of site and facility to construct two 1150 megawatt nuclear generating units (Seabrook Unit 1 and Seabrook Unit 2) at Seabrook, New Hampshire on February 1, 1972. *Re PSNH,* 59 N.H.P.U.C. 127, 128 (1974). That certificate was granted on January 29, 1974. *Id; see also* N.H. Rev. Stat. Ann. §§ 162-F:1 *et seq.*

That the undertaking put the Company on the line *ab initio* is clear. In 1974, when the certificate of site and facility was granted, the estimated cost of the completed project was $1.175 billion. *See, e.g., Appeal of Conservation Law Foundation,* 127 N.H. 606, 649, 507 A.2d 652, 682 (1986) (*Appeal of CLF*) (King, C.J. and Batchelder, J. dissenting) (table setting forth the history of Seabrook cost and schedule estimates). At the same time, PSNH had an approved rate base of $258,918,000.[2] *Re PSNH,* 58 N.H.P.U.C. 111, 115 (1973). Since PSNH was a 50% owner of the project, management had undertaken a project that itself was approximately twice the size of the Company.

To finance such a substantial project, a utility could use two alternative mechanisms. Traditionally, debt and equity financing costs are capitalized as Allowance for Funds Used During Construction (AFUDC) and eventually included in the utility's rate base when the plant becomes operational. Under the alternative methodology, the cost of Construction Work In Progress (CWIP) is immediately

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[2]In New Hampshire, utility revenue requirements are established by the use of the traditional formula which, reduced to its essentials, is R=O+(B x r); where R is the utility's revenue requirement, O is the utility's allowed operating expenses, B is the utility's allowed rate base (defined as the original cost of investment in property used and useful in the service of the public less depreciation), and r is the overall rate of return allowed on the utility's rate base. *See, e.g., Appeal of CLF,* 127 N.H. at 633-634, 507 A.2d at 671.

placed in rate base and financing costs are recovered from ratepayers during the construction period.[3]

On April 27, 1977, PSNH, which had been financing its share of the Seabrook project by using the traditional AFUDC method, initiated a rate proceeding to change to the method of including CWIP in rate base. *Re PSNH,* 63 N.H.P.U.C. 127, 128-129, 138 (1978). The request was opposed by the Legislative Utility Consumers' Council (LUCC) which contended, *inter alia,* that the PSNH proposal violated a statutory requirement that rates only allow a return on "the cost of the property of the utility *used and useful* in the public service . . . ." N.H. Rev. Stat. Ann. § 378:27 (1984) (emphasis supplied); *see also* N.H. Rev. Stat. Ann. § 378:28 (1984).

The New Hampshire Public Utilities Commission (PUC) allowed PSNH to include CWIP in rate base. *Re PSNH,* 63 N.H.P.U.C. at 149-150. In so ordering, the PUC recognized that the AFUDC method would generate insufficient internal cash to meet the Company's construction needs and thus PSNH would be required to obtain cash from the financial markets. *Id.* at 145-146. The PUC also construed the "used and useful" statute as one which allowed the PUC a broad range of discretion. *Id.* at 148. Because the PUC believed that the assurance of future availability of electricity was a benefit to present customers, the PUC concluded that the inclusion of CWIP in rate

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[3]Under either the traditional AFUDC method or the alternative CWIP in rate base method, the principal (or the "bricks and mortar" cost of construction) is recovered after the plant becomes operational through depreciation, which is included in rates as an operating expense.

base in that instance was consistent with its reading of the used and useful statute.

The PUC's order was affirmed by the New Hampshire Supreme Court. *LUCC v. PSNH*, 119 N.H. 332, 402 A.2d 626 (1979). The Court construed the "used and useful" statute as allowing the PUC a broad range of discretion to find that a future plant benefits current ratepayers. *Id.*, 119 N.H. at 343, 402 A.2d at 633. Noting that the PUC had established just such a policy, *id.*, 119 N.H. at 344, 402 A.2d at 634, based on sufficient record support, *id.*, 119 N.H. at 344-347, 402 A.2d at 634-636, the Court ruled as follows:

> We hold that the commission's decision represents a reasonable balancing of the interests of present ratepayers, future ratepayers, and the company's investors. The decision is a policy determination that we will not disturb in exercising our appellate function even if we might have come to a different conclusion.

119 N.H. at 347, 402 A.2d at 636. Thus, the Court did not hold that the PUC's decision was constitutionally mandated; rather the Court deferred to a policy determination which fell within the broad range of regulatory discretion delegated to the PUC by the legislature.

Meanwhile, some members of the legislature would have established a different policy. On May 5, 1977, eight days after PSNH asked the PUC to depart from its traditional AFUDC methodology, the New Hampshire House of Representatives adopted language which was later to become N.H. Rev. Stat. Ann. § 378:30-a (RSA 378:30-a), sometimes referred to as the anti-CWIP law. N.H. House Journal, May 5, 1977 at 627. The measure did not become law during that legislative session; although it was passed

by the State House of Representatives, N.H. House Journal, May 5, 1977 at 630, it was indefinitely postponed by the State Senate, N.H. Senate Journal, June 9, 1977 at 2196-2219. However, the bill was reintroduced during the 1979 legislative session. On May 7, 1979, the measure became law. By passing the statute, the legislature divested the PUC of a portion of the discretion previously delegated and itself performed the policy function of balancing the various interests. *Appeal of PSNH*, 125 N.H. 46, 57, 480 A.2d 20, 27 (1984).

The PUC required the Company to remove CWIP from rate base as of the May 7, 1979 effective date of the statute. PSNH concurrently began again to capitalize its debt and equity financing costs as AFUDC. PSNH management also determined that it could no longer finance a 50% ownership share of the Seabrook facility and sought PUC permission to sell down to a 28% share; an ownership percentage which management contended was consistent with the limits of PSNH's financing ability. The PUC granted the PSNH request. *Re PSNH*, 64 N.H.P.U.C. 286 (1979), *aff'd. sub nom., Appeal of LUCC*, 120 N.H. 173, 412 A.2d 738 (1980).[4]

The Company did not sell down to a 28% ownership level, attaining only its present ownership position of

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[4]In affirming the PUC authorization, the New Hampshire Supreme Court expressly held that "a public utility is not bound to supply consumer energy needs beyond its financial capacity to do so." *Appeal of LUCC*, 120 N.H. at 175, 412 A.2d at 739. PSNH neglected to refer to this holding in its Jurisdictional Statement and thus its assertion that New Hampshire utilities are absolutely obligated to serve all comers is a clear misstatement of law. See PSNH Jur. Stat. at 5, 16 (n. 13) and 19. All PSNH arguments which depend on that assertion should accordingly be rejected.

35.6%. Additionally, PSNH experienced continuing delays and cost escalation in its effort to complete the project.[5] As the Company's financial condition deteriorated, the PUC attempted to implement measures that would maintain the Company as a financially viable entity. In this context, the PUC opened an investigation that culminated in its order at *Re PSNH,* 67 N.H.P.U.C. 490, 47 P.U.R. 4th 167 (1982). In that order, the PUC noted that PSNH management had revised its position and now maintained that it could finance a 35% share of the project to completion. *Id.,* 67 N.H.P.U.C. at 499-502, 47 P.U.R. 4th at 175-178. The PUC also noted its concern about PSNH's worsening financial situation, making specific findings with respect to negative cash flow, asset concentration and PSNH's declining bond ratings.[6] *Id.,* 67 N.H.P.U.C. at 513-514, 529-530, 47 P.U.R. 4th at 187-188, 202-203. To address this situation, the PUC directed PSNH not to apply the proceeds of future financings to the construction of Seabrook Unit 2 unless one of the following conditions was met: 1) successful divestiture down to a 28% ownership level; 2) a demonstration of an equivalent response by other utilities to alleviate PSNH's financial condition; or 3) completion

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[5]Because a high proportion of costs are fixed over time, e.g., financing and labor costs, the single largest factor driving the cost of the facility has been management's inability to complete the project in accordance with its proposed schedule.

[6]Declining bond ratings are one measure of the financial risk attributed to PSNH by the investment community. The lower bond ratings had the effect of increasing the cost of PSNH financing. As discussed below, this increased cost was reflected in PSNH's capital structure both for ratemaking purposes and for the purpose of capitalizing AFUDC.

of construction of Seabrook Unit 1. *Id.*, 67 N.H.P.U.C. at 514-515, 47 P.U.R. 4th at 188-189.

PSNH appealed. In *Appeal of PSNH,* 122 N.H. 1062, 454 A.2d 435 (1982), the New Hampshire Supreme Court vacated the PUC order. The Court held that PSNH had a vested right to engage in its construction program and that PUC interference with that program is a taking which requires just compensation. *Id.,* 122 N.H. at 1069-1072, 454 A.2d at 439-441. The Court relied, in part, on the existence of RSA 378:30-a as support for its holding. The Court reasoned that the statute prevents the PUC from allowing the utility to recover from ratepayers the cost of complying with the PUC order. *Id.,* 122 N.H. at 1071-72, 454 A.2d at 440. The Court also noted that the statute rendered prudence determinations premature. The Court stated:

> Because of the so-called anti-CWIP law, RSA 378: 30-a (Supp. 1981), the day will come when a properly noticed hearing will be necessary to determine what costs associated with Seabrook are to be borne by the *consumers* through electric rates and what costs are to be borne by the *stockholders and investors.* Until that time, there can be no prudency determination because ratepayers are not now paying for Seabrook construction work in progress.
>
> Thus, while management in the first instance may be free generally to make its own decisions about its level of investment in new construction [citation omitted], it must bear in mind that as a regulated company not *all* costs may be recovered from the public when the plant is completed.
>
> A vested right to build is not a vested right to have customers pay.

Id., 122 N.H. at 1076, 454 A.2d at 443 (emphasis in the original).[7]

Although PSNH was experiencing financial difficulties, it was able to meet its financing requirements in the ordinary course (albeit at higher costs caused *inter alia* by lower bond ratings) until its financial crisis of 1984. That crisis was triggered by January, 1984 increases in PSNH's estimates of the construction costs and the completion schedules of the Seabrook Units.[8] As a result of those dramatic increases, PSNH was no longer

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[7]The Court's holding reflects the roles of the PUC and PSNH management under the system of rate regulation developed in New Hampshire. In effect, management is to be given all the rope it desires to attain whatever result it can achieve. At that point, the PUC reviews management actions for rate-making purposes. *See also Appeal of CLF, supra.* Although the *Appeal of PSNH* holding was narrowed in *Appeal of Easton,* 125 N.H. 205, 480 A.2d 88 (1984), to provide the PUC with greater substantive authority over utility financings, it is noteworthy that over the construction life of Seabrook, PSNH has never been denied requested financing authority and the PUC has never interfered with management construction decision-making.

[8]PSNH's estimate of the cost of both Seabrook Units jumped from $5.249 billion to $10.1 billion in January of 1984. *Appeal of CLF, supra.* At the same time the commercial operation date for Unit 1 was extended from December of 1984 to April of 1987. Although PSNH had previously estimated that Unit 2 would be complete in July of 1987, the January 1984 estimate did not include any completion date for Unit 2, reflecting the uncertainty in PSNH's ability to complete that Unit. *Id.* Unit 2 was subsequently cancelled. It is noteworthy that the PUC issued an order approximately eight months before the new PSNH estimates (April 29, 1983) which, after a lengthy formal investigation, rejected PSNH's steadfast defense of its $5.2 billion combined (Units 1 and 2) estimate and the process by which the costs and schedules were calculated and regularly reviewed. The PUC found that a more probable combined cost was at least $8 billion. *Re PSNH,* 68 N.H.P.U.C. 257 (1983).

able to finance Seabrook in the ordinary course and construction was suspended.[9] Recognizing that financing would no longer be routine, the Company devised a plan under which the Company's construction and operational requirements would be pre-financed through to the anticipated completion of Seabrook. *See, e.g., Re PSNH,* 70 N.H.P.U.C. 164, 178-185, 66 P.U.R. 4th 349, 362-369 (1985), *aff'd. sub nom., Appeal of CLF, supra.* The PUC issued an order which provided PSNH with the requisite financing authority to implement its plan. *Id.* The Company was successful in marketing the securities required by the plan, thereby pre-financing company operations and construction to the anticipated completion date.[10]

Unfortunately, the Company was unable to achieve commercial operation within the time estimated in its

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[9]The increased cost estimates triggered additional changes. For example, the Seabrook joint owners required an amendment to their agreement, which amendment provided for construction management via an executive committee of the joint owners, rather than by PSNH management. Additionally, the joint owners hired a new engineer to be in overall control of the construction of the project. From that time forward, the joint owners were able to complete the physical construction of Unit 1 within project cost and schedule estimates. The project is not yet in commercial operation, however, because PSNH management has not yet satisfied the United States Nuclear Regulatory Commission that the plant can be safely operated.

[10]Since this was to be PSNH's last pre-completion financing, the estimate of the completion date was critical. The PUC accepted the Company's estimate of the projected schedule to complete the tasks under the control of the Company (*i.e.*, completion of construction to the point of loading fuel), but rejected as too optimistic the Company's estimate for matters outside of its control (*i.e.*, the time interval between fuel load and commercial operation). The financing approval was sufficient under the more pessimistic assumptions found to be reasonable by the PUC. *Re PSNH,* 70 N.H.P.U.C. at 218-223, 66 P.U.R. 4th at 398-402.

1985 financing. In the Spring of 1987, PSNH attempted to market additional short term debt of $150 million with only limited success. As a result, PSNH management concluded that its access to the financial markets was foreclosed and, on August 5, 1987, initiated a request at the PUC for an emergency rate increase of 15% or $70 million in additional revenues.[11] In its emergency rate increase petition, PSNH sought to include 27% of its Seabrook investment in rate base.[12] PSNH requested that the PUC reserve, certify and transfer to the New Hampshire Supreme Court a question of law on whether RSA

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[11]The rate increase was a component of a PSNH three part plan to forestall bankruptcy. PSNH's claim in its Jurisdictional Statement at 9 that the rate component consisted of the $70 million request to the PUC is not completely accurate. PSNH's plan contemplated additional revenues of $75 million. The $5 million not requested through the PUC was to be recovered through a wholesale rate increase approved by the Federal Energy Regulatory Commission (FERC). Despite the existence of the alleged emergency, PSNH never filed such an application with the FERC.

[12]The proposed Seabrook rate base increase was $464 million. This should be contrasted with the rate base of $619.5 million for PSNH's operating assets approved by the PUC on June 29, 1987. *Re PSNH*, 72 N.H.P.U.C. — (June 29, 1987). Although PSNH proferred evidence of prudency to support its proposed rate base addition, it clearly did not contemplate, nor did the PUC undertake, a prudency review. New Hampshire law provides the PUC with a deadline of 18 months to adjudicate rate requests which include rate base additions of the magnitude proposed by PSNH. N.H. Rev. Stat. Ann. § 378:6 (1984). In all financing orders, the PUC has reserved the issue of prudency. *See, e.g., Re PSNH*, 70 N.H.P.U.C. at 246-47, 66 P.U.R. 4th at 424. Thus, to date the PUC has not determined that management was prudent in its overall decision-making (e.g., need for the facility or continued construction given the escalation of cost; sometimes characterized as "macro-prudency") or in its day-to-day construction management (e.g., size of work-force, materials purchasing, or rework; sometimes referred to as "micro-prudency").

378:30-a may be constitutionally applied to PSNH given its current circumstances. The PUC granted the request and, after intervening proceedings to develop a factual record, the New Hampshire Supreme Court accepted the transfer. After briefing and oral argument, the New Hampshire Supreme Court issued the decision which is the subject of the instant appeal. *Petition of PSNH*, — N.H. —, — A.2d — (January 26, 1988) (PSNH Jur. Stat., App. A) (citation to portions of the decision will be to App. A).

In its decision, the New Hampshire Supreme Court noted that it was addressing an "as applied" rather than a facial challenge to the constitutionality of RSA 378:30-a. The Court correctly found that the law reflected rational legislative policymaking and that PSNH investors had, since the passage of the law, been consistently compensated for bearing construction risk. For those reasons, the Court held that the statute could be constitutionally applied to PSNH. This appeal followed.

ARGUMENT

The Case Presents No Substantial Question Not Previously Decided By This Court.

I. The Issues Presented Are Not Significant Enough To Warrant Plenary Review.

As PSNH concedes in its Jurisdictional Statement at 4, n.2, it is not contending that RSA 378:30-a is facially unconstitutional; the sole issue on appeal is whether RSA 378:30-a is constitutional as applied.

In examining whether the application of an otherwise valid statute effects a taking, the Court does not apply a set formula; rather, the Court conducts "ad hoc factual inquiries . . . with respect to specific property, and the particular estimates of economic impact and ultimate valuation relevant in the unique circumstances." *Hodel v. Virginia Surface Min. & Recl. Ass'n.*, 452 U.S. 264, 295 (1981). Thus, the *ad hoc* factual analysis that the Court would apply in plenary review here would be restricted to the unique factual circumstances confronting PSNH. Such an analysis can have no general applicability. The State's Counterstatement of the Case demonstrates that the PSNH facts are unique in the annals of public utility regulation. No other public utility has created for itself the level of financial exposure experienced by PSNH.[13] Because this appeal turns on particular factual matters which will not have general or recurring applicability, it should be dismissed (or affirmed). *See, e.g., Rice v. Sioux City Cemetery*, 349 U.S. 70, 74 (1955) (the issue must be "beyond the academic or the episodic"), *United States v.*

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[13]Indeed, in its 1982 Order, the PUC made findings of fact about PSNH's financial condition that are typical of the unique circumstances confronting the Company. Those findings include, *inter alia:* 1) internal cash is negative and will remain so until Seabrook Unit 1 operates; 2) "PSNH's percent of earnings related to AFUDC is substantially above the industry standard"; 3) "CWIP as a percent of net utility plant is substantially above the industry standard"; 4) "[t]he size of the PSNH construction program is extraordinary relative to the size of the Company"; and 5) "PSNH's ownership interest in Seabrook represents the heaviest asset concentration in the industry." *Re PSNH*, 67 N.H.P.U.C. at 529-530; 47 P.U.R. 4th at 202-203, *rev'd. on other grounds, Appeal of PSNH*, 122 N.H. 1062, 454 A.2d 435 (1982).

Johnson, 268 U.S. 220, 227 (1925) ("We do not grant a certiorari to review evidence and discuss specific facts").[14]

II. The New Hampshire Supreme Court Correctly Decided The Question Presented.

In *Petition of PSNH, supra,* the New Hampshire Supreme Court determined that RSA 378:30-a could be constitutionally applied to PSNH under the standard articulated by this Court in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) *(Hope)*. The New Hampshire Supreme Court reasoned that *Hope* established the modern standard of constitutional review of utility ratemaking which examines whether the interests of ratepayers and investors have been rationally balanced. Based on its findings that the New Hampshire legislature's balance of the various interests was rational and that the PUC's implementation of the statute provided just compensation, the State Court held that the application of the statute to PSNH was consistent with U.S. CONST. amends. V and XIV.

The New Hampshire Supreme Court's analysis is correct. In *Hope*, this Court rejected the "fair value" constitutional standard previously established in *Smyth v. Ames*, 169 U.S. 466 (1898), a standard that involved the Court in disputes over valuation judgments requiring a circular analysis not grounded in hard accounting data. *See, e.g., Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Com.*, 262 U.S. 276, 290-292, 304 (1923)

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[14]Although *Rice* and *Johnson* were decided in the context of *certiorari*, the importance of the question presented is also pertinent in the context of an appeal. *See, e.g., Wieman v. Updegraff*, 344 U.S. 183, 186 (1952).

(Brandeis and Holmes, J.J., concurring). Instead of a "fair value" standard, *Hope* applied a due process analysis. The Court held that " 'fair value' is the end product of the process of rate-making not the starting point . . . ." *Hope,* 320 U.S. at 601. The appropriate standard of review is to determine whether the total effect of the rate order is just and reasonable. *Id.* at 602. This is done by determining whether the regulator has rationally balanced the interests of the investor and the consumer. *Id.* at 602-603.

Because it was the utility that was challenging the rate order, the *Hope* Court examined whether investor interests were rationally considered. In so doing, the Court articulated several investor interests, including that the utility be given the opportunity to earn sufficient revenue for operating expenses, and debt and equity capital costs. *Id.* at 603. In this context, the Court noted that investors are interested in a return on equity comparable to the return on investments in other enterprises with corresponding risks. *Id.* Additionally, investors are interested in returns that are "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital." *Id.* After ascertaining that the articulated investor interests had been rationally balanced, the Court affirmed the rate order.

Hope required the Court to address a utility contention that rates were unconstitutionally low. Thus, the Court was required to evaluate whether investor interests were rationally considered, but not required to conduct a similar evaluation of consumer interests. This perhaps ex-

plains why the Court did not identify consumer interests at the same level of detail as those of the investor. However, the Court's silence does not mean that there are no consumer interests or that investor interests must always prevail over consumer interests. Nor should the Court's silence be construed as holding that the identified investor interests are of constitutional dimension while consumer interests are not. On a constitutional basis, investor and consumer interests are on an equal footing; the weight to be assigned to each is subject to the rational judgment of the legislature or regulator. *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968). Moreover, a regulator has the discretion to strike a balance in which consumer interests outweigh those of the investor. *Id.* at 769, 792 ("Regulation may, consistently with the Constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness." . . . "The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors."); *Market Street R. Co. v. Railroad Com. of Cal.*, 324 U.S. 548 (1945) (consumers are not required to pay rates to satisfy the investor interest in financial integrity when the enterprise cannot be economically operated). It is therefore clear that the *Hope* analysis is essentially a due process standard; if the process used to establish a rate rationally balanced the various interests, the end result is a "just and reasonable" rate.

See also Appeal of CLF, 127 N.H. at 633-640, 507 A.2d at 671-675.[15]

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[15]The New Hampshire Supreme Court's analysis of *Jersey Central Power and Light Company v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987) (*Jersey Central*) is entirely consistent with the due process standard established in *Hope*. There, the utility was before the FERC, an agency delegated ratemaking discretion coincident with constitutional limitations. *Hope*, 315 U.S. at 586; *Jersey Central*, 810 F.2d at 1175. The FERC summarily rejected the utility's rate request because the utility asked to include cancelled construction costs in rate base, a practice inconsistent with FERC treatment of the issue in a previous case. *New England Power Co.*, 8 F.E.R.C. (CCH) ¶ 61,054 (July 19, 1979), *aff'd. sub nom., NEPCO Municipal Rate Comm. v. FERC*, 668 F.2d 1327 (D.C. Cir. 1981), *cert. denied sub nom., New England Power Co. v. FERC*, 457 U.S. 117 (1982) (*NEPCO*). On appeal, a plurality of the *en banc* United States Court of Appeals for the District of Columbia held that the FERC erred in summarily rejecting the utility's request without first holding a hearing. The plurality grounded its holding on the determination that the FERC's decision did not rest on "adjective law." 810 F.2d at 1170. "The Commission in fact reached and peremptorily decided the utility's claim . . . . In dealing with Jersey Central's rate filings, the Commission applied unclear rules arbitrarily." *Id.* Specifically, the plurality determined that Jersey Central's situation was, on the face of the pleadings, distinguishable from *NEPCO*, 810 F.2d at 1172, and that *NEPCO* was not an "ironclad rule," 810 F.2d at 1183; in fact, the FERC had not established any clear ratemaking policy for the treatment of the cost of abandoned construction, 810 F.2d at 1183-1186, *see also* 810 F.2d at 1188 (Starr, J. concurring). Thus, the FERC's order was not consistent with *Hope* because the FERC had bypassed the process of balancing investor and consumer interests.

On the basis of the foregoing, the New Hampshire Supreme Court correctly determined that the *Jersey Central* holding is inapplicable to PSNH. The narrow *Jersey Central* holding was only that the order of a regulatory agency must be vacated and remanded for a hearing and a statement of reasons where: 1) the legislature has delegated to the agency the discretion to establish a ratemaking policy in a particular area; 2) the agency

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PSNH objects to the New Hampshire process because it was the legislature rather than the PUC which established regulatory policy. Ratemaking, however, is essentially a legislative function. *United States v. Florida East Coast Railway Company*, 410 U.S. 224 (1973); *Appeal of Pennichuck Water Works*, 120 N.H. 562, 565-566, 419 A.2d 1080, 1083 (1980). Clearly, the legislature could decide to exercise itself any regulatory functions previously delegated to the PUC. *See* N.H. CONST. Part II, Art. 2. In exercising these functions, the legislature could constitutionally establish rate policies on an industry-wide basis, even if those policies might produce negative returns in individual instances. *United States v. Florida East Coast Railway Company, supra; Permian Basin Area Rate Cases, supra.* Moreover, it cannot be credibly contended that PSNH is entitled to the same adjudicatory hearing process at the legislature as would be accorded at the PUC. *See, e.g., Atkins v. Parker*, 472 U.S. 115, 130 (1985) (a legislative determination itself provides all the process that is due). It is therefore apparent that it was

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has not exercised its discretion to establish a ratemaking policy in a particular area; 3) the agency nevertheless applies a ratemaking policy in that particular area without giving the parties an opportunity to be heard; and 4) the agency fails to provide reasons to support its action. The *Jersey Central* plurality clearly found that each of the above four deficiencies existed in the FERC proceeding and explicitly held that, if those deficiencies were corrected, the Court would be required to affirm any rational FERC determination. *Jersey Central*, 810 F.2d at 1181-1182 ("When the Commission conducts the requisite balancing of consumer and investor interests, based upon factual findings, that balancing will be judicially reviewable and will be affirmed if supported by substantial evidence. That is the point at which deference to agency expertise will be appropriate and necessary.").

proper for the legislature to adopt regulatory policies by statute.

It is also apparent that the legislative policy established in RSA 378:30-a reflects a rational balance of the relevant interests. A number of policy choices existed; the legislature could have: 1) continued to delegate discretion to the PUC; 2) required the exclusive application of a prudence standard;[16] or 3) provided a narrow definition of the used and useful standard as applied to investment in plant under construction. The legislature chose to define narrowly the used and useful standard so that ratepayers are required to pay only for plant which is literally "used and useful"; *i.e.*, plant which "is actually providing service to consumers." RSA 378:30-a. This policy choice was rational. While after *Hope* the used and useful standard may perhaps no longer be considered to be of constitutional dimension, *see Denver Union Stock Yard Co. v. United States*, 304 U.S. 470 (1938), it still retains vitality as an articulation of the consumer interest in only paying a return on investment

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[16]The prudent investment test is analogous to a negligence standard in determining whether investment should be reflected in rate base. *Appeal of CLF*, 127 N.H. at 637, 507 A.2d at 673-674. If the investment was foreseeably wasteful at the time it was made, it can be excluded from rate base. *Id.* This test has been cited with favor. *See, e.g., Bluefield W.W. & Improv. Co. v. Public Serv. Com.*, 262 U.S. 679, 693 (1923) ("[t]he return should be reasonably sufficient . . . under efficient and economic management . . ."); *Missouri ex rel. S.W. Bell T. Co. v. Public Serv. Com., supra; Washington Gas Light Co. v. Baker*, 188 F.2d 11, 19 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951). However, the prudent investment test "was not to become the prevailing rule." *Democratic Cent. Com. of D.C. v. Washington M.A.T. Com'n.*, 485 F.2d 786, 801 (D.C. Cir. 1973) (footnote omitted).

devoted to the public use. *Petition of PSNH*, App. A at 16a.

The legislature recognized that a strict used and useful policy might cause utilities cash flow or other financial difficulties, *see, e.g.*, N.H. Senate Journal, April 24, 1979 at 604-615, but made the permissible determination that the consumer interest in the traditional rule outweighs investor interests on this issue. This is supported by the legislative rationale that the policy allocated construction risk to investors, rather than ratepayers. *See, e.g.*, N.H. House Journal, May 5, 1977 at 626-627 (Report of the N.H. Science and Technology Committee).[17] Such risk allocation, while more expensive for consumers, *id.*, serves a public function. The Committee stated:

> The public relies on the expertise of the bond market to oversee the investment decision of public uitilities (sic) and assure that those decisions are made on the basis of sound economics. Unless the public can undertake this oversight function, it should not remove the incentives for lenders to consider carefully their investment by guaranteeing both the principal and the interest of the loan.

Id. PSNH cannot now attack this legislative analysis; it remains reasonable on its face. *Vance v. Bradley*, 440 U.S. 93, 111-112 (1979) ("it is the very admission that the facts are arguable that immunizes from constitutional attack the congressional judgment").

The foregoing demonstrates that the New Hampshire Supreme Court correctly determined that RSA 378:30-a

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[17]As previously noted, the bill introduced in the 1977 session is identical to the language ultimately adopted in the 1979 session as RSA 378:30-a.

was a rational legislative balance which allocated construction risk to investors. The State Court also correctly determined that investors have received just compensation for bearing this risk.

Compensation for risk is the primary factor in determining the rate of return allowed for utility debt and equity instruments included in the utility's capital structure. *Hope,* 320 U.S. at 603; *Bluefield W.W. & Improv. Co. v. Public Service Com.,* 262 U.S. at 691-693.[18] In *Jersey Central,* 810 F.2d at 1208-1209, the dissent addressed the importance of this factor. Judge Mikva noted that it would be unfair to consumers to require them to compensate investors for the risk of loss and then to exact the cost of the loss from consumers in the event that it occurs. In *Jersey Central,* the Court did not have before it a record which would allow it to determine whether investors had already been compensated for risk. *Id.* In contrast, the New Hampshire Supreme Court had a record on which it could determine that the just and reasonable rates established by the PUC since the effective date of the anti-CWIP law compensated investors for the construction

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[18]In this context, the regulatory compact discussed by PSNH in its Jurisdictional Statement at 13-14 provides that, while investors may not be entitled to the benefits of the "peaks" of windfall profits, they will also be insulated from the "valleys" of losses by the entitlement to just and reasonable rates for their monopoly franchise. This compact affects the risk of investment and, thus, the rate of return. However, the return also reflects the fact that while investors may be shielded from some risks, they may not be shielded from others. *See, e.g., Market Street R. Co. v. Railroad Com. of Cal., supra* (market risk). The compensation for the type of risk from which investors are not shielded is included in the overall rate of return established by the regulatory agency.

risk of Seabrook. Such compensation occurred both as a matter of law and as a matter of fact.

As a matter of law, PUC findings that the rates established in its orders are just and reasonable are final unless and until they are vacated by an appellate court or modified by the PUC. N.H. Rev. Stat. Ann. § 365:25 (1984). PSNH is therefore foreclosed from contending at this late date that such final adjudications (including establishment of rates of return) resulted in rates that were not just and reasonable. *Appeal of White Mountains Educ. Ass'n.*, 125 N.H. 771, 486 A.2d 283 (1984) (doctrine of *res judicata* applies to administrative proceedings).

As a matter of fact, the PUC has historically allowed investors to recover for risk. In *Re PSNH,* 64 N.H.P.U.C. 295, 306 (1979), the PUC explicitly recognized that the anti-CWIP law made PSNH riskier and that investors may have to be compensated for such increased risk. In *Re PSNH,* 65 N.H.P.U.C. 45 (1980) (PSNH Jur. Stat., App. J), the PUC considered whether it must exclude construction financing securities from PSNH's capital structure and exclude construction risk from the cost of PSNH's equity. The PUC rejected the contention that the anti-CWIP law requires such exclusion and concluded that it was appropriate to establish an overall rate of return based on its review of all the factors, including construction risk, that are inherent in such an evaluation. 65 N.H.P.U.C. at 48-51, 53-54, PSNH Jur. Stat. App. J at 84a-88a, 92a.[19] The PUC adhered to this reasoning in *Re*

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[19]PSNH challenged the New Hampshire Supreme Court's finding that this regulatory decision approved an enhanced rate

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PSNH, 65 N.H.P.U.C. 251, 275-276 (1980). In *Re PSNH*, 69 N.H.P.U.C. 67, 57 P.U.R. 4th 563 (1984), the PUC had before it a record which quantified the effect on base rates of including Seabrook financing instruments in the capital structure. The PUC found that the inclusion of such instruments increased PSNH's revenue requirement by $25 million. 69 N.H.P.U.C. at 83-84, 57 P.U.R. 4th at 579. The inclusion of this revenue requirement was challenged by the Consumer Advocate and the CRR. The PUC concluded "that RSA 378:30-a does not act as a barrier to recovery of Seabrook related costs as a part of a utility's rate of return." 69 N.H.P.U.C. at 85, 57 P.U.R. 4th at 581. The PUC thus included the cost of Seabrook financing instruments in its overall rate of return calculation, thereby increasing the Company's rates by $25 million.

In the only rate proceeding to take place since PSNH's 1984 financial crisis (with its concomitant effect of lack of access to financial markets) the PUC continued to recognize that the cost of capital should include compensation to investors for construction risk. *Re PSNH*, 72 N.H.P.U.C. — (June 29, 1987) (App. 1). With respect to debt, the PUC allowed PSNH to include its high cost debt in-

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of return as a "miscitation." PSNH Jur. Stat. at 20. While it is correct that the PUC found that the rate of return was not "enhanced" in the sense that "the commission has found a level of return and just added some enhancing factor," PSNH App. J at 85a, it is also true that the decision, read as a whole, affirms the requirement that PSNH's return reflect the appropriate risks pertinent to that Company and that PSNH's capital structure include securities that were issued for the purpose of constructing Seabrook. *See, e.g.*, PSNH App. J at 92a. Although the New Hampshire Supreme Court's language may have been less than precise, its overall holding is clearly correct. Thus, reversal would not be warranted on this point.

struments (with rates "as high as 20 percent," PSNH Jur. Stat. at 8) in its capital structure subject to later prudency review. App. 1 at 6A-8A, 13A-15A. With respect to equity, the PUC rejected a PSNH proposed return of 19% based on risk factors particular to it; however, a risk premium was explicitly recognized. The PUC found a cost of equity of 13%; a figure at the high end of the Staff's Discounted Cash Flow (DCF) range. To that high end cost the PUC added a risk premium of 2% calculated by subtracting the cost of equity of utilities not engaged in nuclear construction from the similar cost of utilities engaged in nuclear construction. Thus, PSNH was allowed the opportunity to earn a 15% return on equity. App. 1 at 8A-13A, 15A-18A.[20]

PSNH seeks to attack the State Court's finding that the rates of return historically allowed the Company adequately reflected risk by claiming that the court ignored: 1) the cost and lead time necessary to construct electric capacity; and 2) the fact that no investors would invest in a utility located in an anti-CWIP state. PSNH Jur. Stat. at 19. There was no error, however, because PSNH's assertions cannot be considered to be relevant "facts."

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[20]PSNH appealed the PUC order based *inter alia* on the issue of whether the PUC adequately recognized PSNH's risk by selecting a number at the high end of the DCF range and adding a 2% risk premium instead of accepting the PSNH number of 19%. *Petition of PSNH*, App. A at 11a-12a. PSNH's assertion that the current appeal involves "a *refusal* by the PUC to include *any* such enhancement of rate of return," PSNH Jur. Stat. at 21, n.20 (emphasis in original), is a clear misstatement. The pending appellate dispute over the *quantification* of a risk premium cannot affect the correct analysis adopted by the New Hampshire Supreme Court that a risk premium had been included in the Company's allowed equity return.

PSNH had proffered no evidence on these points at the PUC and therefore it is not surprising that the PUC made no findings on these points.[21]

PSNH also attaches significance to the fact that the returns discussed above were allowed only on a rate base which, pursuant to RSA 378:30-a, excluded CWIP. Investors have been compensated for the CWIP part of the risk of their investment, however, through the rate at which AFUDC has been and is being capitalized. PSNH will have the opportunity to include this AFUDC in rate base when the facility becomes operational as a part of the facility's cost. Thus, the AFUDC mechanism does not deprive the utility of the opportunity to recover the cost of financing; it merely defers that opportunity until construction is completed. The deferral of compensation, with the corresponding recovery of the cost of deferral, does not deprive the utility of any property (or investment) and thus cannot constitute a taking.

PSNH suggests that compensation through capitalized AFUDC is somehow not real and thus is not just compensation. PSNH Jur. Stat. at 23. However, PSNH

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[21]In any event, investors were clearly on notice of the risks of investing in PSNH at all pertinent times—each PSNH prospectus and other securities' solicitation material disclosed the risk of Seabrook schedule delay and cost escalation. Additionally, all such material issued as of the effective date of RSA 378:30-a disclosed the existence of the statute and the risks attendant thereto. Yet, PSNH had continued access to the financial markets, albeit at the higher costs occasioned by lower bond ratings, up to and including the time of its 1984 financial crisis. As discussed previously, that crisis was triggered by the dramatic increase in PSNH's cost and schedule estimates, not by the existence of RSA 378:30-a, which had been enacted some five years earlier.

has never offered to forego rate base inclusion of the AFUDC portion of Seabrook when and if it seeks rate base treatment for the facility. Indeed, the $464 million rate base addition sought by PSNH in the instant matter has a substantial component of both debt and equity AFUDC. Moreover, until the fall of 1987, when PSNH began to default on interest payments, investors were receiving cash returns on investment; returns that could be higher than 20%.[22] Of course, PSNH investors are now at risk because of pending bankruptcy proceedings, but this is one of the risks for which they received compensation up until the time of default. As noted by the New Hampshire Supreme Court, the Company should not be permitted to receive compensation from ratepayers for risk and then to require ratepayers to pay for the consequences when the risk turns sour. *Petition of PSNH*, App. A at 12a-13a.

The foregoing demonstrates that PSNH begs the question when it asserts that "[s]ubject only to a limitation of ratepayer exploitation, the right to nonconfiscatory, just and reasonable rates is otherwise absolute." PSNH Jur. Stat. at 14. No party has disputed PSNH's entitlement to "just and reasonable" rates; the issue, however, is whether the rates established under the current New Hampshire regulatory structure are "just and reasonable." The New Hampshire Supreme Court correctly determined

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[22]It is true that PSNH has not paid an equity dividend since 1984. However, it has always had the opportunity through rates to earn a reasonable return and it has been capitalizing equity returns as a part of AFUDC. Although the PUC has required that PSNH obtain prior approval before paying a cash dividend, PSNH Jur. Stat. at 8, PSNH management has never sought such approval.

that it was proper for the legislature to establish the regulatory policy. Additionally, the State Court correctly determined that the policy reflects a rational balance of all pertinent interests. Finally, the State Court correctly determined that PSNH investors have received just compensation for the risks allocated to them by the regulatory policy. The *Hope* standard, which provides that no particular ratemaking policy is required, cannot be converted into a prohibition against the adoption of regulatory policies by the appropriate legislative and administrative bodies. Under *Hope,* PSNH's rates are "just and reasonable." Accordingly, this Court should decline to note probable jurisdiction.

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CONCLUSION

Wherefore, appellee respectfully submits that the question upon which this case depends is so unsubstantial as not to need further argument, and appellee respectfully moves the Court to dismiss this appeal, or, in the alternative, to affirm the judgment entered in the cause by the New Hampshire Supreme Court.

Respectfully submitted,

STEPHEN E. MERRILL
Attorney General
LARRY M. SMUKLER*
Senior Assistant Attorney General
Civil Bureau
25 Capitol Street
Concord, New Hampshire 03301-6397
(603) 271-3658

Attorneys for Appellee

**Counsel of Record*

April 29, 1988

APPENDIX 1

Excerpts from *Re PSNH*, 72 N.H.P.U.C. —
(June 29, 1987)

DR 86-122

PUBLIC SERVICE COMPANY OF
NEW HAMPSHIRE

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IV. *CAPITAL STRUCTURE AND COST OF CAPITAL*

Testimony on the appropriate capital structure was presented by PSNH, the Consumer Advocate and Staff; testimony on the cost of capital, equity, debt and preferred stock, was offered by PSNH and Staff. The Consumer Advocate, in his brief, supported the Staff calculations for equity, but his position on capital structure affects his calculation of the overall costs of debt and preferred as it removes certain capital issues from the weighted average. CRR supported the rate of return position of the Consumer Advocate. The BIA, DOD and did not present testimony or argument on capital structure or cost of capital.

A. *Capital Structure*

1. *Position of the Parties*

PSNH, through its witnesses Professor J. Peter Williamson and Bruce W. Wiggett support the following capital structure:

Common Equity	$1,028,741,000	37.57%
Preferred Stock	321,551,000	11.74
Long Term Debt	1,387,791,000	50.69
Total Capitalization	2,738,083,000	100.00

In Wiggett's Schedules, this capital structure is the calculation of the actual capital structure as of September 30, 1985 (the end of the test year) proformed to reflect the maturity of First Mortgage Bond Series I in June 1986 and Promissory Notes BV and NV in August 1986 and the issuance of the Deferred Interest Third Mortgage Bonds Series A and $100 Million of Pollution Control Revenue Bonds in February 1986. Williamson terms the proposed capital structure appropriate for ratemaking purposes, although "a little high on long-term debt and a little short on common equity" (Exhibit 1, Tab. 6, p. 21) in comparison with the electric industry. The Company does not record the June 1986 write-off of the $353,521,000 investments in Seabrook II and Pilgrim II, or implicitly, treats the write-off as if it occurred equi-proportionally against all components of the capital structure and did not change the component ratios. PSNH adopts this treatment of the write-off because a write-off only against common equity lowers the common equity ratio and thereby lowers the overall cost of capital assuming, as the Company argues, the return on equity exceeds the embedded cost of debt.

The Company argues that the Commission has the authority to adopt a capital structure for ratemaking purposes different from the capital structure as shown on the books of the Company. In particular, it cites various rate cases of the New Hampshire Electric Cooperative as well as PSNH's last rate case, in which the Commission approved the use of "target ratios" rather than an actual capital structure. PSNH concludes that to reduce the allowed rate of return on existing rate base by adjustments to the component ratios of the capital structure when

substantial amounts of uncompleted plant are written off is to further weaken the financial integrity of a Company that has just suffered the write-off.

Staff through its witness, Dr. Sarah P. Voll, proposes the following capital structure (Ex. 49, Att. 1, p. 1):

Common Equity	$ 817,137,738	32.14%
Preferred Stock	312,127,087	12.28
Long Term Debt	1,412,924,904	55.58
Total Capitalization	2,542,189,729	100.00

Staff's capital structure represents the Company's actual capital structure as of August 31, 1986 as it appears on the books of the Company, adjusted for unamortized premiums and discounts. It therefore includes not only the additions and deletions of capital issues as proformed by the Company, but the write-off of the Seabrook II and Pilgrim II investments against retained earnings. Staff contends that the accounting standards require that cancelled plant be written off against retained earnings, in part since prior to a plant being used and useful the investment is made at the stockholders' risk. Staff argues then that its proposed capital structure best reflects the reality of the events that affected the Company's capital structure through August 1986.

2. *Commission Analysis*

The Commission agrees with the Company that we have the authority to adopt for ratemaking purposes a capital structure different from that which appears on the Company's books at any given time. In general, how-

ever, the Commission adopts a hypothetical capital structure either to reflect more accurately the general reality of the period during which the rates will be in effect, or to encourage the utility to conform this reality to a desired optimum. The Commission's acceptance of "target ratios" in the last rate case was an example of the former case. During the period while the rates were in effect, the "target ratios" were expected to represent, on average, the Company's capital structure more closely than any instantaneous set of capital ratios taken at any particular point during the Company's financing program.[1]

The Company's proposal in the instant case is founded on neither of the reasons the Commission has in the past adopted hypothetical capital structures. It does not accurately reflect an expected reality, as PSNH has in fact written off the cancelled plant against common equity. The debt issues remain intact in the Company's capital structure as on-going obligations of the Company, regardless of the reduction to rate base. Nor will a hypothetical capital structure serve to encourage PSNH to move in an optimal direction, in this case to increase the equity component in its capital structure. Professor Williamson has testified that "the Company has found new offerings of common or preferred stock not to be practical until dividends are restored" (Ex. 31, p. 18); and Staff apparently agrees: "PSNH has no intention of raising capital through offerings of common stock until the stock price has sub-

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[1] The New Hampshire Electric Cooperative cases cited in brief by the Company do not apply. The 70:30 proforma capital structure was proposed by the NHEC witness but not adopted by the Commission. The Commission's findings were based on TIER coverage rather than hypothetical capital structure.

stantially recovered." (Voll, Ex. 13, p. 16). In addition, the Company's argument that reductions in the allowed rate of return should not be allowed to further weaken the financial integrity of a Company that has just suffered a write-off depends on the relationship between the Company's embedded cost of debt and marginal cost of equity. Where a Company's embedded cost of debt is heavily weighted by financings that were issued in periods of high interest rates, its marginal cost of equity reflecting a period of lower interest rates will not necessarily exceed the debt costs. Therefore, a lower equity component ratio will not necessarily result in a lower overall allowed rate of return and a further weakening of the Company's financial integrity.

We do not find that the Company has presented sufficient evidence or argument to cause us to adopt a hypothetical capital structure in the instant case. We find that the Staff recommendation best represents the reality of the PSNH capital structure and will accept it for purposes of this docket.

B. *Cost of Capital Debt and Preferred Stock*

1. *Position of the Parties*

The Company recommended costs of debt and preferred stock based on the weighted averages of the issues in its proformed capital structure, calculated according to a yield to maturity methodology. The results, as updated, were 13.41% on preferred stock and 15.18% on long term debt (Ex. 33, Sch. IV, p. 2; Sch. V, p. 4.)

Staff, using the accounting based embedded methodology as adopted by the Commission in DR 77-49,

Re Public Service Company of New Hampshire, obtains results of 13.28% on preferred stock and 15.28% on long term debt. Ex. 49, p. 3 and Att. 1, pp. 1-3. In addition, Staff noted that it views the current rate case as a pre-Seabrook interim rate case and the prudency of the debt financings is being examined by the Commission as part of the Seabrook prudency audit. Staff therefore recommended that its calculations be adopted subject to refund pending the outcome of the Commission deliberations in the Seabrook rate case.

Given that the results of the two methodologies were very similar, the parties agreed to accept Staff's results without prejudice, although PSNH does not accept Staff's methodology to the exclusion of PSNH's method in calculating the costs of debt and preferred stock.

2. *Commission Analysis*

The Commission finds the agreement of the parties reasonable given the similarity of the results in this docket. We will defer findings on appropriate methodologies in the calculation of the cost of debt and preferred stock to a future rate case.

The Commission notes the Staff recommendation that its calculations be adopted subject to refund. The Commission also views the current rate case as an interim rate case. Our orders cited by Staff were premised on the assumption that the next rate case would be the Seabrook rate case and that the prudency of the cost rates would be determined concurrently with the prudency of the entire Seabrook investment. Our acceptance of the Staff calculations in this interim case should not be viewed as a finding on the prudency of the cost rates on

the Seabrook related debt issues. Rather, that prudency determination will be made when the Seabrook investment is rate based, and we intend to reconcile all issues of prudency at that time.

The Commission unanimously agreed that cost rates imprudently incurred must be refunded to ratepayers, but reach an impass on the method to implement the refund. The problem developed from the Commission, in previous decision dating back to 1982, deferring the prudency issue until a thorough prudency review of the construction project was concluded. When those decisions were made, everyone contemplated the next rate case to be the prudency case. No one has yet developed a record to determine any imprudency or quantify same. In fact, the Commission is currently utilizing a consultant to assist it as the prudency docket is processed.

The Commission is confronted in this rate case with the requirement of RSA 378:6 which mandates that permanent rates be filed by June 30, 1987. To fix rates one day and the next day declare those rates as temporary rates is not an appropriate method to employ and is subject to be attacked as a ploy by the Commission to circumvent the requirement of RSA 378:6.

The majority of the Commission is convinced that the Company was on notice before this hearing and during the course of this hearing that the questions of prudency would be deferred until a prudency hearing was conducted. We believe that fairness and equity dictates that it be done after a full and complete hearing. If the parties had an objection to this procedure, they had the opportunity to address it. They did not; therefore, we are confident that

making the rates of this proceeding subject to refund for the limited purpose of determining what portion of the costs rates for debt was imprudent is proper, fair and equitable. The dissenting view would not eliminate the problem of retroactive ratemaking. The majority's objective is to defer the issue until a full prudency hearing can be concluded. The difference of opinion between the majority and the dissent is in adopting the proper methodology.

C. *Cost of Capitol—Common Equity*

1. *Position of Parties*

Public Service Company recommended a return on equity of 19% based on the direct, supplementary and rebuttal testimony of its witnesses Prof. J. Peter Williamson and Robert G. Rosenberg and the rebuttal testimony of Daniel P. Rudakis.

Williamson estimates PSNH's cost of equity using a risk premium methodology. In his December update (Exh. 8) he reaffirms his earlier finding of 19% using the same methodology as in his original testimony. He calculates risk premiums of PSNH debt instruments above Baa Yields by comparing PSNH prices and yields to maturity to the Moody's Baa average. He derives a premium for preferred stock by using a discounted cash flow under varying assumptions of the resumption of dividend payments on preferred stock. His results are as follows:

First Mortgage Bonds	Baa yield + 1 to 1½%	= 10.8% to 11.3%
G&R Bonds	Baa yield + 4%	= 13.5%
Debentures	Baa yield + 4.5%	= 14.3%
Preferred Stock	Baa yield + 8 to 10%	= 17.1% to 19.1%

Williamson then places a conservative estimate of the cost of common equity at 18-20%, 100 basis points above

the cost of preferred, and recommends 19% as the midpoint.

Rosenberg estimates the cost of common equity using a discounted cash flow (DCF) methodology based on a sample of 30 nuclear constructing companies as 13.30%. Exh. 27, p. 3. He then develops two risk premiums to measure the risk differential between PSNH and the sample by comparing the yields on their first mortgage bonds (4.92 - 5.30) and on their most junior securities (4.88 - 5.01). Therefore, his two analyses result in the following ranges: 18.22 - 18.60%, and 18.18 - 18.31%. However, recognition of two additional risk factors not captured by his risk analysis, the uncertain status of PSNH dividends and PSNH shareholders riskier position compared to debt holders with regard to regulatory outcomes, result in a recommendation of 19%. Resenberg also performed a comparable earnings analysis based on data ending in January 1986 in his original testimony but did not update it for consideration at the time of the hearings.

Staff presented the testimony of Dr. Sarah P. Voll who recommended a range of 11.63% to 13% with a point estimate of 11.94%. She utilized the DCF methodology to analyze a group of 35 electric companies of approximately similar size as PSNH. Her 11.94% result is based on the average of the entire sample using historical growth rates while the upper end of the range (13%) reflects the expectation that investors probably expect future growth rates to be healthier than the growth rates of the immediate past. 6 Tr. 610-611. Voll states that it is inappropriate to recognize for ratemaking purposes the level of return desired by investors in PSNH common stock. She

argues that PSNH is viewed as a speculative investment by investors, and that "profits such as are realized or anticipated in . . . speculative ventures" offend the judicial standard as enunciated in *Bluefield Water Works & Imp. Co. v. Public Service Comm. of West Virginia*, 262 U.S. 679, 692-693 (1923) [hereinafter cited as *Bluefield*].

2. *Commission Analysis*

The three rate of return witnesses have presented the Commission with a wide range of estimates of the allowed cost of equity for PSNH. The estimates are calculated according to two different methodologies, the risk premium (Williamson) and the DCF (Voll) or a combination of both (Rosenberg). In general, this Commission has found the DCF method based on a sample of comparable companies to be the preferred methodology. Risk premiums themselves are subject to considerable variation during different time periods and at different interest rate ranges, with the spreads between equity and debt being particularly uncertain. In the instant case we are particularly troubled by the uncertainty surrounding Williamson's calculation of the risk premium of the preferred, which requires assumptions concerning investor expectations on the resumption of preferred dividends, and on the lack of documentation of the spread between preferred and common, especially in his update. Therefore we will base our findings on the DCF methodology as presented by Voll and Rosenberg, as well as taking note of the Federal Energy Regulatory Commission's (FERC) DCF derived generic rate of return of 11.43% covering the period November 1, 1986 to January 31, 1987 as reported at FERC Statutes and Regulations, ¶ 14,059.

The DCF methodologies from these three sources are approximately the same and, using Rosenberg's update, are based on data from similar time periods. The difference in the results stems primarily from the differing samples. Voll's 11.94% (historical growth rates) and 13% (forecasted growth rates) are based on a sample of 35 smaller electric utilities, including both companies with and without nuclear involvement. The FERC bases its estimate (11.43% for the six-month time period ending September 30, 1986) on a sample of 100 electric utilities of varying sizes. Rosenberg's sample of 30 companies is essentially the nuclear sub-set of the FERC sample and produces a basic DCF result of 13.30%.

The fundamental disagreement between the Voll and Rosenberg lies not in their DCF results but in the risk premium to be assigned to PSNH to recognize the riskiness of its nuclear involvement. The existence of that added risk is not a matter of dispute: Voll noted in both prefiled (Exh. 13, p. 116) and oral (6 Tr. 621) testimony that PSNH was riskier than her sample. In fact, she bases her non-recognition of an added risk premium on the argument that PSNH is so risky that from an investor perspective, its stock is a speculative investment.

Of the available DCF analyses, we find the sample used by Voll of 35 of the smaller electrics to be most appropriate. We will accept the upper end of her range (13%) as an estimate of investor expectations on the performance of an average of the smaller electric utilities in the period during which rates will be in effect. We find that her point estimate of 11.94% is too low. That estimate is based on historical data and includes 18 companies with nuclear involvement for whom investors undoubt-

edly expect healthier levels of dividends and earnings growth in the future than they have experienced in the past. To compensate for this reasonable expectation, we choose the upper end of Dr. Voll's range of 13% as reasonable.

The final question is what risk premium, if any, should be added to this DCF result to recognize the added risk of PSNH. While we agree with Staff that full recognition of the investor required return may offend the standards enunciated in *Bluefield* concerning speculative investments, we do not agree that it logically follows that *Bluefield* prohibits any recognition of added risk. There is unquestionably a level of added investor risk that accompanies an electric utility's involvement in nuclear construction even for companies that are by no means speculative. The dissent fails to recognize this reality. We believe that an estimate of this greater than average risk can be obtained by comparing the FERC DCF analysis based on a sample of diverse companies (11.43%) to Rosenberg's results based on a sample of companies with nuclear involvements (13.30%). This differential of 187 basis point represents a legitimate "greater than average" risk faced by companies with nuclear construction programs that in no way offends the *Bluefield* strictures against returns on speculative ventures. We will therefore add this risk premium to the DCF result of the 13% return on the sample of diverse smaller electric utilities to obtain a return on equity of 14.87%. For ratemaking purposes, we find 15% to be a reasonable estimate of the return on equity for PSNH.

Based upon the foregoing analysis, the cost of capital is calculated as follows:

	Total	Percent Rate	Cost Weighted Cost
Long Term Debt	55.58%	15.28%	8.49%
Preferred Stock	12.28	13.28	1.63
Common Equity	32.24	15.00	4.82
Total	100.0%		14.94%

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VI. SEABROOK CAPITALIZATION

The Consumer Advocate objects to including in the cost of capital, for ratemaking purposes, the amount and cost rate of any securities which could have provided sources of funds for PSNH's Seabrook construction program. The Consumer Advocate uses the same rationale to support his motion to dismiss PSNH's petition. The Consumer Advocate argues that PSNH's request for a return on rate base is derived from a weighted average of all the Company's capital including capital invested in Seabrook. He concludes that this methodology violates the provisions of RSA 378:30(a). This is the third time that the Consumer Advocate raises this issue. (See *Re PSNH*, 65 NHPUC 251, 275-276 (1980); *Re PSNH*, 69 NHPUC 45, 53 (1984).)

In *Re PSNH*, 69 NHPUC 67, 83-86, [57 P.U.R. 4th 563, 578-581,] the Commission addressed the identical issue presented in this proceeding and concluded that RSA 378:30(a) does not address the methodology used to determine an appropriate rate of return and held that RSA 378:30(a) does not act as a barrier to recovery of Seabrook related costs as part of the utility's rate of return.

The Commission did not rest its decision on the factual evidence, but rather, on the Commission's interpretation of RSA 378:30(a). *Re PSNH,* 69 NHPUC 65, 85-86 [57 P.U.R. 4th 563, 580-581].

The Consumer Advocate attempts to rely on language used by the Court in *Re PSNH,* 125 N.H. 46 (1984) as authority to require a departure from the previous decisions of the Commission. We do not agree with the Consumer Advocate's interpretation of that case.

The analysis that a particular cost rate for a particular security instrument is reasonable is an issue which must be undertaken in the context of a financing proceeding pursuant to RSA 369. Therein the terms and conditions, among other things, are examined as to reasonableness in light of current market conditions. When the Commission developed a concern over the impact on rates, it reversed any prudency determination. 67 NHPUC 956; 68 NHPUC 5; 68 NHPUC 118; 68 NHPUC 418; 68 NHPUC 412; 68 NHPUC 612; 69 NHPUC 279. The Commission is currently examining the entire prudency issue of the Seabrook project and has engaged a consultant to assist it. The results of that proceeding will be applied to all issues of prudency appropriate for ratemaking.

Although the Commission did not rely on the factual evidence in past proceedings and does not do so herein, it should be observed that Dr. Voll's analysis in DR 82-333 was only a first approximation and that many adjustments would have to be made including adjustments for a risk premium and overall cost of money for the Company. Dr. Voll's testimony in this proceeding is similar and consistent with her testimony in DR 82-333. Tr. Vol. 6, pp. 495-501. Dr. Nichols, the Consumer Advocate's

witness in this proceeding, did not do any independent analysis but noted that his methodology simply extended upon Dr. Voll's testimony. Tr. Vol. 13, p. 70. Nor did he read or analyze the previous decisions of the Commission. Tr. Vol. 13, p. 71. He merely relied on what the Consumer Advocate instructed him as to the facts and the law. The record does not reflect any evidence or compelling reason to justify departure from the previous Commission orders or from the long-standing Commission practice.

The Commission has re-examined its prior decisions and the evidence presented in this proceeding and finds there is no compelling reason to change the methodology for calculating rate of return.

Based on the above reasons, the Consumer Advocate's Motion to Dismiss PSNH's Petition is denied.

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DR 86-122

PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE

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Opinion of Commissioner Aeschliman

Dissenting in Part

At the conclusion of this proceeding Public Service Company of New Hampshire (PSNH) was supporting a revenue deficiency of $38,682,000. (PSNH Brief, Appendix A) The majority opinion provides for a rate increase of $20,490,866. I would grant a rate increase of

$13,699,592. The difference of $6,791,274 is based upon different findings relative to the appropriate rate of return on equity to allow for ratemaking purposes in this case. The majority has allowed 15%; I would allow 13%. There are also procedural differences in the manner in which we would treat revenues related to the debt cost component of the rate of return.

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Rate of Return on Equity

The majority has calculated rates based upon a 15% return on equity. This is a very high return given prevailing market rates. For comparison, the rate of return on equity granted to PSNH in January 1984 was 16.1%. Since that time interest rates have fallen some 400 basis points, and a comparable rate of return today would be closer to 12%. I would allow a 13% return which Dr. Voll's testimony indicates is the "plausible upper limit for a reasonable return on equity for ratemaking." (Exh. 14, p. 9). A return at this level gives appropriate recognition to the risk of nuclear construction. The majority in adding an additional premium double counts this risk.

The rate of return on equity is derived from an analysis of market data rather than from Company specific cost rates which are used in the calculation of debt costs. The primary methodology used in this jurisdiction is the discounted cash flow (DCF) analysis. This analysis involves the selection of a sample of utility companies of similar size and business risk from which the data is obtained to perform a DCF analysis.

Dr. Voll's testimony indicates that an appropriate sample is one that includes relatively small electric utilities, particularly those that are involved in the con-

struction of nuclear power plants but have not experienced the type of liquidity crisis that would lead to a suspension of dividends and would place them in the category of speculative investments. (Exh. 13, p. 17). Her DCF analysis for utilities with construction programs resulted in a total expected return of 11.63% (Exh. 14, p. 18). This return was actually lower than the return for non-nuclear utilities because the historical dividend growth rates for the nuclear utilities was very low resulting in a slightly lower total return even though the required yield was higher. If forecasted dividend growth was used rather than the historical growth rate, the expected return for utilities with construction programs was calculated to be 12.94%. It is important to note that the 12.94% applies only to nuclear constructing utilities and not to Dr. Voll's sample of 35 utilities as a whole. The 12.94% provides the basis for Dr. Voll's conclusion that 13% is the upper limit that can be justified by the DCF analysis. (Exh. 14, p. 19 Rev.).

The majority has taken Dr. Rosenberg's DCF sample which comprises large nuclear constructing utilities and has derived from his analysis a risk premium for this group of nuclear constructing utilities compared with a Federal Energy Regulatory Commission (FERC) sample of diverse utilities. Their analysis then adds Dr. Rosenberg's risk premium to Dr. Voll's upper limit of 13% to obtain a 14.87% rate of return which is then apparently rounded up to 15%.

There are two basic flaws to this approach. First, Dr. Rosenberg's sample of large nuclear constructing utilities is not an appropriate comparison group because their size is not comparable to PSNH. It should also be noted

that Dr. Rosenberg's analysis for nuclear constructing companies yields a result of 13.3% which includes the premium for risk of nuclear construction. Second, Dr. Voll's upper limit of 13% already includes an adder for nuclear constructing utilities above the 11.94% calculated return for her diverse sample of small utilities. Thus, the difference between 11.94% and 13% is a risk premium for small nuclear constructing utilities. To add a further premium double counts the risk. Consequently, the majority has reached a result which is not supported by the testimony of any expert witness and which cannot withstand critical analysis. Since Dr. Rosenberg's analysis and Dr. Voll's analysis incorporate nuclear risk in reaching their 13.3% and 13% DCF results, a 15% level can only be reached by adding additional risk premiums due to PSNH's speculative situation.

My analysis would result in an overall rate of return of 14.30%, which is a high return by present market standards. It is the most I believe should be allowed in this case absent a prudency review.